No. 24

In the Supreme Court of the United States

OCTOBER TERM, 1960

UNITED STATES OF AMERICA, PETITIONER

v.

E. B. HOUGHAM, OWEN DAILEY, WILLIAM E. SCHWARTZE AND HARLAN L. MCFARLAND

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

REPLY BRIEF FOR THE UNITED STATES

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Respondents urge numerous grounds in support of the judgment below in addition to that on which the court of appeals based its decision and to which our opening brief was primarily directed. Their argument on the merits,[1] as we understand it, resolves itself into four distinct contentions: (1) the Government failed properly to put in issue in the trial court its asserted right to double-consideration damages under § 26(b)(2) and the trial court accordingly never ruled on the question; (2) § 26(b)(2) is by its

[1] On the question of mootness, respondents' arguments are fully answered in our main brief (pp. 17–20) and no further comment is necessary here.

terms inapplicable to the transactions here because they did not involve executory "agreements"; (3) even if § 26(b)(2) is technically applicable, the trial court had a discretionary power to choose another remedy it deemed more "appropriate" (the ground of the court of appeals' decision); and (4) while the election of § 26(b)(1) damages in the original complaint was not "irrevocable" as a matter of law, a change of election should not be allowed here because it would be prejudicial to respondents. We will reply to the arguments in the order indicated.

I

THE GOVERNMENT'S ELECTION OF DOUBLE-CONSIDERATION DAMAGES UNDER § 26(b)(2) WAS MADE IN THE PRE-TRIAL ORDER AND RULED ON IN THE TRIAL COURT'S CONCLUSIONS OF LAW

Respondents contend that the Government never put in issue in the trial court its right to elect double-consideration damages under § 26(b)(2) and that the court therefore properly entered judgment for the $2,000 assessments prayed for in the original complaint and the second amended complaint. The original complaint asked for $2,000 assessments under § 26(b)(1) (R. 22–23); the first amended complaint, in addition to correcting numerous substantive allegations, asked for double-consideration damages under § 26(b)(2) (R. 42–43); the second amended complaint made only the corrections to the substantive allegations and repeated the original prayer for relief under § 26(b)(1) (R. 72–73). The basis for respondents' argument is that the motion to file the first amended

complaint, the only formal pleading in which the § 26(b)(2) election was made, was never ruled upon by the trial court but was voluntarily withdrawn by the Government.

We agree that the first amended complaint was in fact withdrawn without a formal ruling of record and therefore did not constitute an effective election of the § 26(b)(2) remedy. The answer, however, is that the Government does not rely upon the pleadings for its election but rather upon the pretrial order which superseded the pleadings. And in the pretrial order the Government did expressly elect double-consideration damages under § 26(b)(2).

a. Although the proceedings on the motion to file the first amended complaint are not, we think, material, clarification of those proceedings is required in order to correct a possible misstatement in our main brief. We there stated that the district court "denied" the motion to file the first amended complaint (Br. 5). The record reference given (R. 116) was to the district court's post-trial conclusions of law which in turn state that, in considering the motion and other pretrial matters, the court had "ruled" that the original complaint was an irrevocable election of § 26(b)(1) damages and the government had thereupon withdrawn the motion. We acknowledge, as respondents contend (Resp. Br. 4–6), that neither statement is precise insofar as it implies that the court formally "denied" or "ruled" on the motion. In fact, the motion was withdrawn without being put to a formal ruling on the record (see R. 48, 54).

What occurred is more accurately stated in the pretrial order which recites that "Previously the Court has *indicated* that an irrevocable election" was made by the original complaint (R. 101; emphasis added). That is, the court did not formally rule on the motion to file the first amended complaint but merely indicated in the pretrial conferences its view that the relief sought in the original complaint was an irrevocable election and could not be amended. Government counsel, in order to make the other needed amendments (to the substantive allegations) which the court indicated it would allow, thereupon withdrew the motion and substituted the second amended complaint, deferring to later proceedings the assertion of the Government's right to elect double-consideration damages.

b. The point at which the election of double-consideration damages was reasserted and made part of the record for a formal ruling was in the pretrial order. Respondents acknowledge that the pretrial order, quoted at page 5 of our main brief, does expressly state the Government's election of double-consideration damages under § 26(b)(2) (R. 101). The pretrial order, however, is then simply brushed aside by respondents as an "incorrect summation of the record" (Resp. Br. 4). Respondents' mistake is that a pretrial order does not depend for its efficacy upon its accuracy as a summation of the prior pleadings. It operates of its own force as a superseding and controlling statement of the positions of the parties and the issues to be resolved, and, if there be

an inconsistency with the pleadings, it is the pretrial order, not the pleadings, that controls.

That a pretrial order may modify the pleadings and is thereafter controlling is made express by the Federal Rules of Civil Procedure. Rule 16 provides that, after pretrial conferences, the court "shall make an order which recites * * * the amendments allowed to the pleadings * * * and such order when entered controls the subsequent course of the action, unless modified at the trial to prevent manifest injustice." Consistently with the Rule, the pretrial order here, after stating the Government's contention that it was not bound by its original complaint and its election of double-consideration damages (R. 101), itself recites, with the approval of the parties,[2] that "this order shall supplement the pleadings and govern the course of the trial of this cause, unless modified to prevent manifest injustice" (R. 104).

Respondents' objection that, after withdrawing the first amended complaint and filing the second, the Government never again formally amended its complaint to elect the § 26(b)(2) remedy is, therefore, patently without substance. The election was made in the pretrial order itself, the complaint was thereby superseded (except, of course, for purposes of the reserved contention that the original complaint was

[2] The parties' signatures appear under the caption "Approved as to form and *context*" (R. 104; emphasis added). Presumably "context" is a misprint for "content"—otherwise it is meaningless—but the parties' formal endorsement is immaterial in any event. The order is that of the court, and the proper form by which to object to its content would be by a motion to amend the order, and none was made here.

an irrevocable election), and there remained nothing to amend.[3] In short, the pretrial order fully and effectively stated the Government's contention that it was then entitled to elect double-consideration damages, its election to do so, and respondents' opposing contention that the original complaint was an irrevocable election of the $2,000 assessments, thereby squarely putting the question to the court for a formal ruling. That ruling was forthcoming in the court's final conclusions of law, which expressly held that the original complaint was an irrevocable election of $2,000 assessments under § 26(b)(1) and that the purported election of double-consideration damages under § 26(b)(2) in the pretrial order was therefore ineffective (R. 116–117). The question was, therefore, fully presented to and ruled upon by the trial court and no more was required (if, indeed, more was possible) to preserve the question for appeal.

II

SECTION 26(B)(2) IS APPLICABLE BY ITS TERMS TO THE TRANSACTIONS INVOLVED

Respondents apparently contend that, even if properly and timely elected, the § 26(b)(2) remedy is inapplicable by its terms to the transactions involved here. The argument is that, since § 26(b)(2) provides for recovery of "twice the consideration *agreed to be*

[3] Respondents' assertion that the "Government elected to proceed to trial on the Second Amended Complaint" (Resp. Br. 6, 27) suffers, of course, from the same misapprehension. The Government proceeded to trial on the pretrial order—which "shall * * * govern the course of the trial of this cause" (R. 104)—and not on the second amended complaint.

given" (emphasis added), it applies only if at some stage of the transaction there is outstanding an executory "agreement" for payment; that all the purchases here were "spot cash transactions" (Resp. Br. 10) in which there was no hiatus between award and payment; and hence, while there was consideration given, there was no consideration "agreed" to be given.

Even accepting the premise that the sales were of the character asserted by respondents—a premise unsupported and in fact contradicted by the record[1]—the argument is, we think, specious. There is no possible justification, of policy or otherwise, for distinguishing between fraudulent purchases effected by a-

[1] Respondent Dailey testified that "basically" these sales "were bid sales" conducted both in person and by mail order, and that "If you were awarded the merchandise you paid for it in either cash or by certified check" (R. 173–174). Koenig, former surplus property disposal officer, testified that there were auction sales with sealed bids, spot sales (both bid type and fixed price), and mail order sales on a national solicitation basis for veterans; some of these being restricted to veterans and others with veterans and other buyers participating (R. 237, 241, 244, 245–246, 247, 252). The documents which record the sales reflect the systematic processing which accompanied the determination of the veteran's eligibility, the bid or mail order, the commitment of the agency to sell a particular item to the prospective purchaser, the payment of money, and delivery of possession which was sometimes effected by rail (R. 247–253). At one stage in this processing the veteran signed a certificate reading in part (R. 252):

"The purchaser agrees to buy the property listed herein in accordance with the attached sales conditions * * *".

Obviously at that point the purchaser has agreed to buy certain property at a certain price, and acceptance by the seller makes the agreement binding. No matter how long or short the hiatus between that step and the payment of money and subsequent delivery, there is then, contrary to respondents' assertion, an executory contract of sale.

"bid" and "award," with a time lapse before actual payment, and those effected by a simultaneous exchange of money for goods without an antecedent executory "agreement." In either case the fraud is the same and the injury to the governmental program is the same. The reason for stating the measure as the consideration "agreed" to be paid rather than that "paid"—which respondents suggest would have been more appropriate—was simply to make clear that the subsection would be applicable even if the transaction had not been consummated, not to exclude consummated transactions simply because there was no hiatus during which they were executory.

Moreover, even in an over-the-counter sale the parties necessarily "agree" that the goods shall be exchanged for an agreed-upon consideration. Plainly, for example, if by miscounting the money the purchaser paid less than the stated price, an action on the contract would lie for the balance of the amount "agreed" to be paid. Thus even in the contract sense there is an "agreement" to pay whether or not the contract is executed simultaneously with its making.

It may be noted, finally, that the theory of the Government's proof in this case was in fact the amounts "agreed" to be paid rather than those actually paid. The sales documents introduced showed the prices at which the various sales were concluded. While they also reflect that the full prices were actually paid, it would obviously have made no difference to the Government's recovery if it appeared that, through an error of addition, the Government had in fact been underpaid or overpaid on several purchases. That is

to say, while in this case the amounts "agreed" to be paid and those actually paid appear to have been the same, it remains true that the theory of the proof and of the claimed recovery turns upon the amounts "agreed" to be paid as distinguished from (should there be a variance) the amounts actually paid.

III

THE TRIAL COURT HAS NO DISCRETION TO SELECT AS MORE "APPROPRIATE" A REMEDY OTHER THAN THAT ELECTED BY THE GOVERNMENT AND DID NOT PURPORT TO DO SO

Intertwined with respondents' argument that § 26 (b)(2) is inapplicable as a matter of law is the quite separate argument that, even if technically applicable, the courts below had and exercised a discretionary power to disallow that remedy on the ground that it was not "appropriate" under the circumstances, presumably because no actual damages had been proved. That question—the power of the court to choose among the several remedies the one it believes most "appropriate"—is the main subject of our opening brief, and only a few additional comments need be made here.

In the first place, no court has in fact found double-consideration damages to be inappropriate in this case. The court of appeals did not purport to make such a finding *de novo* but held only that "It cannot be said upon the record before us that the trial court reached an erroneous conclusion" in so finding (R. 457)—*i.e.*, that the district court did not abuse *its* discretion in finding double-consideration damages to be inappropriate. The district court, however, never made or even implied such a finding. It based its decision

squarely, exclusively, and explicitly on the ground that the filing of the original complaint was an "irrevocable election" of $2,000 assessments under § 26(b)(1) (R. 117).[5] The court of appeals, in turn, expressly rejected that ground of decision (R. 456–457). Plainly, having rejected the sole basis for the district court's decision, the court of appeals could not then affirm its judgment on the ground that a finding never made by it was not "clearly erroneous."[6]

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[5] Respondents' assertion that the district court did not base its decision on that ground (Resp. Br. 26; 23–24 n. 7) flies in the teeth of the express language of the conclusions of law. The quotation relied upon (Resp. Br. 26 n. 8; R. 445–446) is of the court's oral comments on the number of "acts" to which the $2,000 assessments under § 26(b)(1) would apply, not on the grounds for applying § 26(b)(1) instead of § 26(b)(2).

[6] In addition, we submit, any question of actual damages or of the relationship of the § 26(b)(2) remedy to probable damages was excluded from the case by the pretrial order. With respect to the remedy under § 26(b)(1) (on the assumption that the court would, as it had indicated, restrict the Government to that remedy), the Government expressly limited itself to claiming the $2,000 fixed assessments and abandoned any attempt to prove actual damages (R. 94). With respect to the Government's contention that it was entitled to elect double-consideration damages under § 26(b)(2), the only counter-argument preserved in the pretrial order was the claim that the original complaint was an irrevocable election (R. 101). Respondents did not contend that double-consideration damages—if not foreclosed by the original complaint—would be inappropriate because disproportionate to actual damages or in any other way put in issue the question of actual damages. The order limited the issues to be litigated, both of fact and of law, to those stated therein "and no others" (R. 91, 101), thus removing any occasion for the Government to undertake to demonstrate affirmatively the reasonable relationship of the double-consideration remedy to the probable damages.

It is clear in any event, we think, as shown in our main brief, that the statute expressly places the choice among the alternative remedies in the Government and that the district court would have had no power to select one or the other as more "appropriate" even if it had purported to do so. In particular, respondents' apparent suggestion that the court may disallow the Government's election of double-consideration damages unless the Government affirmatively proves actual damages of an order approximating the recovery would defeat the very purpose of the statute. As this Court observed in *Rex Trailer Co.* v. *United States*, 350 U.S. 148, 153–154, the very reason for providing for liquidated damages is the difficulty, or even impossibility, of proving the actual damages because of the numerous and intangible governmental interests injured by the fraud.

Respondents rely (Resp. Br. 11 n. 3) upon the caveat in the *Rex Trailer* opinion implicit in the concluding statement that "On this record it cannot be said that the measure of recovery * * * is so unreasonable or excessive that it transformed what was clearly intended as a civil remedy into a criminal penalty" (350 U.S. at 154). We do not disagree with that caveat and may acknowledge the possibility of circumstances arising in which the application of one or the other of the several remedies would produce a recovery which is on its face so totally disproportionate to any possible compensatory purpose as to make it penal. It may be noted, however, that that possibility is more inherent in the $2,000 assessment of § 26(b)(1), with which the Court was concerned in *Rex Trailer*, than

in the double-consideration measure of § 26(b)(2). The reason is that the $2,000 assessment is an arbitrary figure having no necessary relationship to the magnitude of the fraudulent transaction. It applies in terms equally to the fraudulent purchase of a desk stapler or of a defense plant, and circumstances can readily be conjured up in which its strict application would indeed produce extreme results (*e.g.*, 100 separate purchases of $1.00 desk staplers, producing an assessment of $200,000). The recovery under § 26(b)(2), on the other hand, being measured by the consideration agreed to be given, is automatically tailored to the magnitude of the fraudulent transaction. Indeed, if double the consideration is a reasonable measure of the probable damages in the typical case—which no one denies—it is difficult to imagine any case in which it would not be, for the recovery always bears the same relationship to the size of the transaction.

In any event, the existence of potential constitutional limits on the recoveries that might be allowable under the Act means only that when those are transgressed the courts may refuse to allow the recovery in whole or in part. It does not mean that within those limits the trial court may restrict the Government in its election to that remedy the court deems more "equitable" or "appropriate". The choice among the constitutionally permissible remedies of the one best suited to a particular case is a choice the statute expressly commits to the Government, and so long as the application of the remedy elected by the Government does not produce an unconstitutionally

excessive result—which is not claimed here—the Government's election must be given effect.

IV

THE ELECTION OF DOUBLE-CONSIDERATION DAMAGES WAS TIMELY AND DID NOT PREJUDICE RESPONDENTS

If, as we contend, § 26(b)(2) is in terms applicable to the facts here and the Government has the right to elect among the several remedies, the only question remaining is whether the election under § 26(b)(2) was timely made. The district court, as noted above, held that the original complaint was an irrevocable election of the § 26(b)(1) remedy, precluding a later election of § 26(b)(2). The court of appeals rejected that ground and respondents, themselves characterizing it as an "arbitrary stand" (Resp. Br. 26), abandon it here.[1] Respondents' argument is the much

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[1] Even the common-law doctrine of election of remedies—itself termed "a harsh, and now largely obsolete rule". *(Friedrichson* v. *Renard*, 247 U.S. 207, 213)—was never applicable to the mere filing of a complaint praying for one measure of damages rather than another, the remedies being "alternative" but not "inconsistent." See, *e.g.*, *United States Fidelity & Guaranty Co.* v. *First National Bank*, 172 F. 2d 258, 262, n. 3 (C.A. 5); *McMahan* v. *McMahon*, 122 S. C. 336, 342, quoted at Resp. Br. 28. Whatever the common-law rule, moreover, it is plain that under the notice-pleading and liberal-amendment philosophy of the Federal Rules of Civil Procedure substantive rights are no longer to be foreclosed on such technical rules of pleading. See *Bernstein* v. *United States*, 256 F. 2d 697 (C.A. 10); cf. *Hickman* v. *Taylor*, 329 U.S. 495, 500–501; *Conley* v. *Gibson*, 355 U.S. 41, 48; 2 Moore, *Federal Practice*, § 2.06(3), p. 362. Equally plainly, there is nothing in the Surplus Property Act requiring the final election to be made upon the initial filing of the complaint. *Bernstein* v. *United States*, *supra*.

more limited one that, after electing one measure of damages in the original complaint, the Government can thereafter change the election only on the terms on which amendments are generally allowed under the Federal Rules—*i.e.*, by leave of court to be "freely given when justice so requires" (Rule 15(a)).[8] Respondents then argue that the change of election should not be allowed here because the case was tried on the § 26(b)(1) theory of damages and they would suffer "great prejudice" if the Government were allowed to change its election "after trial" (Resp. Br. 23, n. 7; 29–30).

Even if the election had not been changed until after trial, as respondents assert, we question how the measure of damages—both alternatives being based on the same transactions and the same proof—could in fact have affected the conduct of the trial. The complete answer, however, is that the Government asserted its final election of § 26(b)(2) damages *before*, and not after, the trial. The change of election was made, as shown in Point I, *supra*, in the pretrial order entered almost a full month before trial (see R. 105),

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[8] Resp. Br. 21–22. The above, as we understand it, is the only argument of respondents that goes strictly to the question of the timing of the election. Many of the arguments which respondents subsume under the heading of "election" go to the quite different questions we have already discussed—whether the Government *ever* made an election of § 26(b)(2) damages (Point I); whether § 26(b)(2) applies to the transactions as a matter of law (Point II); and whether the court can reject a remedy elected by the Government on the ground that another is more appropriate (Point III)—and have been dealt with in the preceding portions of this reply brief.

and even at that time respondents had been on notice ever since the abortive proceedings on the motion to file the first amended complaint that the Government intended to assert its election of § 26(b)(2) damages at an appropriate time. At the time of the pretrial order, respondents made no claim of prejudice resulting from the change of election, and the pretrial order preserved as an objection to the change of election only the contention that the original complaint was an irrevocable election. Respondents were therefore fully aware of the Government's election of § 26(b)(2) damages—subject only to the asserted bar that the original election was irrevocable—well before they proceeded to trial and cannot now claim they were misled in the conduct of the trial. In short, respondents' claims of prejudice resulting from the change of election are based entirely on their basic misapprehension, dealt with in Point I, *supra*, of the effect of the pretrial order. When their claim that no election of § 26(b)(2) damages was ever made falls, their claims of prejudice fall with it.

Respectfully submitted.

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